DEBTOR'S INTERFERENCE IN THE ELECTION OF A TRUSTEE IN BANKRUPTCY.

GENERALLY in the Continental systems of bankruptcy legislation it is the policy of the law for the court to appoint its own official administrator to handle the bankrupt's estate. The creditors may be consulted, or even have some advisory or supervisory control over the official court administration, but the actual executive control of the assets is in the hands of the court official.[1]

In the English bankruptcy system it is a cardinal principle that the creditors are to have the full control of the administration of the bankrupt's estate. The court is merely the supervisory power. The last English Bankruptcy Act of 1883[2] gives the creditors an absolute right to name the trustee who shall administer the estate in their behalf. The Board of Trade may for cause object to the selection of the creditors, and the High Court will pass on the validity of the objections, which may be for any of three causes: first, that the appointment was not made in good faith; second, that the appointee is not a fit person. The only persons absolutely disqualified are the official receivers, or a person who has previously been removed from the office of trustee for misconduct or neglect. Third, that the relations of the appointee are such that it would be difficult for him to act impartially.

In this country the policy of bankruptcy legislation on this subject has not been uniform. Beginning with our first Bankruptcy Law in 1800, Congress gave to the creditors the fullest liberty in the choice of the trustee. The Act of 1800 provided that the major part in value of the creditors should choose a person or persons to whom the bankrupt's estate and effects should be transferred.[3] No approval of the choice on the part of the court was provided for.

In the Bankruptcy Act of 1841, however, the Continental practice was adopted. The title to the bankrupt's estate was vested in an assignee appointed by the court.[4]

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[1] Dunacomb, Bankruptcy, Columbia College Studies in History, etc., No. 2, p. 2.
[2] 46 & 47 Vict. c. 53.
[3] Bankruptcy Act of 1800, § 6.
[4] Bankruptcy Act of 1841, § 3.

Evidently the system of official court assignees was found unsuited to American conditions, for in 1867 the Bankruptcy Act passed in that year followed more nearly the English practice. It left the creditors to choose one or more assignees of the estate of the debtor subject to the approval of the district judge.[1] The general orders of the Supreme Court expressly prohibited the appointment by the district judges of any official assignees or any general assignees to act in any class of cases.[2]

The Bankruptcy Act of 1898 was closely modeled after the Act of 1867 regarding the selection of the trustee in bankruptcy, although its provisions are not wholly consistent. The bankruptcy court is invested with power to appoint trustees pursuant to the recommendation of creditors.[3] On the other hand, the creditors themselves are given the absolute right to appoint one or three trustees.[4]

This conflict in the statute has led to a curious result. Not only has the Supreme Court copied the old General Orders under the Act of 1867 that no official trustees shall be appointed,[5] but has engrafted a limitation on the free right of selection of the trustee on the part of the creditors that the appointment "shall be subject to be approved or disapproved by the referee or by the judge."[6] There is clearly no warrant for this usurpation on the part of the court. The General Order plainly seeks to borrow from the Act of 1867 one of its provisions that Congress has not seen fit to reenact in the present statute. Although there has been no judicial disapproval of this order, one of the leading text-book writers on bankruptcy has already expressed doubts of its validity, and the expectation that this general order will not stand the scrutiny of the court that promulgated it.[7]

The seven years of practice under the present statute has furnished an unbroken precedent of the selection of the trustee by the creditors. The court never undertakes to exercise its right of appointment under its general power, and names a trustee under the express authority given it under section 44 only when the creditors fail or neglect to exercise their rights. The selection of

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[1] Bankruptcy Act of 1867, § 13.
[2] General Orders, IX, Supreme Court, October term, 1874.
[3] Bankruptcy Act of 1898, § 2 (17).
[4] Bankruptcy Act of 1898, § 44.
[5] General Orders, XIV, 172 U. S. 657.
[6] General Orders, XIII, 172 U. S. 657.
[7] Collier, Bankruptcy, 4th ed., 330.

a trustee is an important and substantial right of the creditors. It is a matter of first importance in every case. Much of the success of the present Bankruptcy Act depends on an intelligent safeguarding of this privilege to the creditors on the part of the courts.

Under our present statute one of the most important questions relating to the election of a trustee has arisen in a class of cases where the bankrupt seeks to influence or control the selection of the person who is to be trustee. The bankrupt may have much to gain from the appointment of a favorable trustee. Often his creditors are widely scattered and unknown to each other, their respective claims may be small, and important only in the aggregate. Negligent, complaisant, and friendly creditors will be only too ready to follow a request or suggestion of a debtor who may have traded with them for years or who may hold out hopes of future advantages. For a time at least the names and addresses of the creditors are in the exclusive control of the bankrupt. It is very easy to see how the debtor who desires to stifle an investigation, or to regain speedy control of his estate can turn all this to his advantage. It is an easy matter for the bankrupt to solicit the claims or proxies of his various creditors and elect his nominee to the office of trustee over the efforts of an unorganized and widely scattered body of creditors. It is, of course, obvious that such action is a gross fraud on the creditors, and that any court to whose attention this state of affairs is brought should make every effort to defeat such a scheme.

The first time such a question was brought to the attention of a court was in 1821 in the English case of *Ex parte Shaw*.[1] After a contested election a petition was presented in behalf of the defeated candidates to the Lord Chancellor, praying that the assignment of the estate to the persons who had received the majority of votes might be stayed and that the same be executed to them. One of the grounds of this request was that the election had been procured by the canvas and solicitation of the bankrupts. The Vice-Chancellor, Sir John Leach, was of the opinion that the choice should be avoided. "It is against the first principles and the whole policy of the bankrupt laws to permit bankrupts indirectly to choose their own assignees." When this question was presented to Lord Eldon on appeal, he dodged a decision by finding the choice invalid on other grounds. This case, however, has always

[1] 1 G. & J. 125.

been cited as sustaining the view of the Vice-Chancellor, and it became a fixed principle of the English bankruptcy practice that such interference by the bankrupt avoided the election,[1] until finally the subject seems to be satisfactorily covered by express provision of their bankruptcy statute.

Unfortunately the courts in this country who have considered this subject have not agreed upon either the theory or method of dealing with the problem. All our courts recognize that the whole policy of the Bankruptcy Law is to give to creditors the free, deliberate, and unbiased choice in the first instance of the person who is to administer the assets of the bankrupt estate. The present statute is very carefully drawn to check undue control of the bankrupt's affairs, either by a few interests, or by the bankrupt's influence in connection with them to the prejudice of the general body of creditors.[2] To elect a trustee a majority vote both in number and value of the creditors present and voting is necessary.[3] This insures that neither one large predominating creditor may choose a trustee in his interests, nor that several insignificant creditors in combination may elect a trustee to the prejudice of what may be the only substantial interests in the proceedings.

On the other hand, it is equally certain that an honest bankrupt can have no real interest in the choice of the trustee. The creditors alone are the beneficiaries in the administration of the estate.

"The trustee's duties are administrative, not judicial. It is not his special duty 'to hold an even hand or an unbiased mind' towards the bankrupt, but to make the most possible out of the assets, and in the performance of this duty mere bias or unfriendliness toward the bankrupt must be rarely, if ever, material. Considering the number and frequency of fraudulent bankruptcies in the past, a zealous watch and scrutiny of an insolvent's transaction cannot be looked upon as demerit, or as indicative of a lack of 'competency' in a trustee. And unfounded suspicions and prejudice even may be met by the honest merchant without fear." [4]

Where there is evidence sufficient to establish that the bankrupt or his representatives have interfered with the election of a trustee, two possible courses seem to be open to the minority creditors. They may challenge the vote, or may demand that the referee

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[1] *Ex parte* Molineaux, 3 M. & Ayr. R. 703; *Ex parte* Carter, 3 De G. & J. 116.

[2] *In re* Henschel, 109 Fed. Rep. 861, 6 Am. B. Rep. 305.

[3] Bankruptcy Act of 1898, § 56 a.

[4] *In re* Lewensohn, 98 Fed. Rep. 576, 3 Am. B. Rep. 299. See also *In re* Clairmont, 1 N. B. Rep. 276.

disapprove the election. Some of the cases have held that the mere fact that the vote is influenced or controlled by the bankrupt in his own interests is no ground for objecting to it. The only mode of raising such an objection is by opposing the approval of the election.[1] Other cases have allowed the challenge of the votes so cast,[2] while one of the more recent cases held that the referee may either decline to receive the votes, or to approve the election.[3]

The present Bankruptcy Law has very carefully defined the qualifications of the trustee:

"Trustees may be (1) individuals who are respectively competent to perform the duties of that office, and reside or have an office in the judicial district within which they are appointed, or (2) corporations authorized by their charters or by law to act in such capacity and having an office in the judicial district within which they are appointed."[4]

When the bankrupt is attempting to control the election of the trustee, he is usually sufficiently clever to select as his candidate some individual of personally irreproachable character who is perfectly competent to fill the position.[5] Conceding the validity of the General Orders, rule XIII, how can the referee withhold his approval to such a candidate if he is the selection of the unchallenged vote of the majority in value and number of the creditors? The discretion to approve or disapprove which he may exercise is not an arbitrary power. It must rest on the basis of some provisions of the statute.[6]

"The referee should not disapprove of the choice of a trustee by creditors, nor should he interfere with, or influence such choice except upon clear proof of incompetency for performance of duty or non-residence."[7] Even under the Act of 1867, in which, with one exception,[8] there was no specific disqualification for a trustee, and a general discretion to approve or disapprove of the election

[1] *Re* Noble, Fed. Cas. 10282, 3 N. B. Rep. 96; *Re* Frank, Fed. Cas. 5050, 5 N. B. Rep. 194; *Re* Bliss, Fed. Cas. 1543, 1 N. B. Rep. 78; *Re* Wetmore, Fed. Cas. 17466, 16 N. B. Rep. 514; *Re* Rekersdres, 108 Fed. Rep. 206, 5 Am. B. Rep. 811.

[2] Falter *v.* Reinhard, 104 Fed. Rep. 292, 4 Am. B. Rep. 782, 106 Fed. Rep. 57, 5 Am. B. Rep. 155; *Re* Henschel, *supra;* Matter of Law, 13 Am. B. Rep. 650.

[3] Dayville Woolen Co., 114 Fed. Rep. 674, 8 Am. B. Rep. 85.

[4] Bankruptcy Act of 1898, § 45.

[5] Boston Dry Goods Company, 125 Fed. Rep. 226, 11 Am B. Rep. 97; *Re* Henschel, *supra.*

[6] Bump, Bankruptcy, 10th ed., 132. *Cf.* also *Ex parte* Sheard, L. R. 16 Ch. D. 107.

[7] *Re* Lewensohn, *supra.*

[8] A person who had accepted an unlawful preference. Act of 1867, § 5035.

was given to the district judge, with power to order a new election when "needful or expedient," the court considered it was justified in withholding its approval of the election only where there was a want of capacity or integrity in the candidate elected. Otherwise he was assignee "by virtue of the law." [1]

The real point at issue is not whether the trustee so chosen is qualified so as to be approved or disapproved by the referee, but whether the votes which were wrongfully influenced by the bankrupt shall be accepted. There is no doubt that a creditor is the only person entitled to vote for a trustee. If the referee upon inquiry learns that the bankrupt is casting the votes in his creditors' names, it is obvious that he may reject such votes. If there is fraud practised on a creditor who votes in person, it is not much more difficult to find that, although it is the creditor who goes through the form of voting, yet in fact it is the bankrupt who casts the vote. So, too, in a case of collusion between a creditor and the bankrupt, it is the bankrupt who by consent of such creditor casts the vote in the creditor's name. In each of these cases it is the bankrupt's voice which is substituted for his creditors' in selecting the trustee. Just as the English Bankruptcy Law separates the objections which attack the election on the ground that the appointment was not made in good faith into a different class from those objections dealing with the personal fitness of the appointee, so this method of dealing with our problem distinguishes the question of the votes from all questions of approval or disapproval of the trustee elected.

The natural hesitancy of a referee formally to disapprove of the selection of some gentleman of character and standing in the local community who has been ensnared into the bankrupt's scheme often results in a substantial denial of the rights of the creditors to elect their trustee.[2] It befogs the issue and begs the whole question for the referee to resort to a question of disapproving of the trustee. In fact, what the creditors ask the court to pass upon is not whether the trustee is personally qualified or disqualified, but whether or not he has been elected to the office by the votes of the creditors. When a referee finds that the bankrupt directly or indirectly controlled the votes, he finds that the creditors did not cast the votes. Just as in any election for any office the election

[1] *In re* Barrett, Fed. Cas. 1043, 2 N. B. Rep. 533; *Re* Grant, Fed. Cas. 5693, 2 N. B. Rep. 106. *Contra*, *Re* Wetmore, *supra*; *Re* Bliss, *supra*.

[2] *Re* Boston Dry Goods Co, *supra*.

judges reject false votes, irrespective of the candidate for whom they are cast, so in such cases it is the duty of the referee to refuse these votes without passing on the qualifications of the appointee.

Moreover, there is an additional advantage in rejecting the votes rather than in disapproving of the trustee. If the court withholds its approval, it can neither declare the rival candidate elected, nor appoint a trustee of its own choosing. It can only order a new election.[1] There is no promise that a second election will yield any better results. By rejecting the fraudulent or corrupted votes the ballots of the independent creditors will control the election, and the court may be assured of a competent official who is the real choice of those creditors of the bankrupt who are alert in their own interests and have no ulterior object other than the best possible administration of the bankrupt's estate.

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[1] *Re* Scheiffer & Garrett, Fed. Cas. 12445, 2 N. B. Rep. 591; *Re* McKellar, 116 Fed. Rep. 547, 8 Am. B. Rep. 699; *Re* Hare, 119 Fed. Rep. 246, 9 Am. B. Rep. 520.